From:	Sam Liccardo
To:	Hadnot, Rhonda
Subject:	Fwd: Governor Newsom’s Revised Budget Proposal
Date:	Tuesday, September 17, 2019 11:57:16 AM

---------- Forwarded message ---------
From: **David Crane** [redacted]
Date: Wed, May 15, 2019 at 8:59 AM
Subject: Governor Newsom’s Revised Budget Proposal
To: [redacted]

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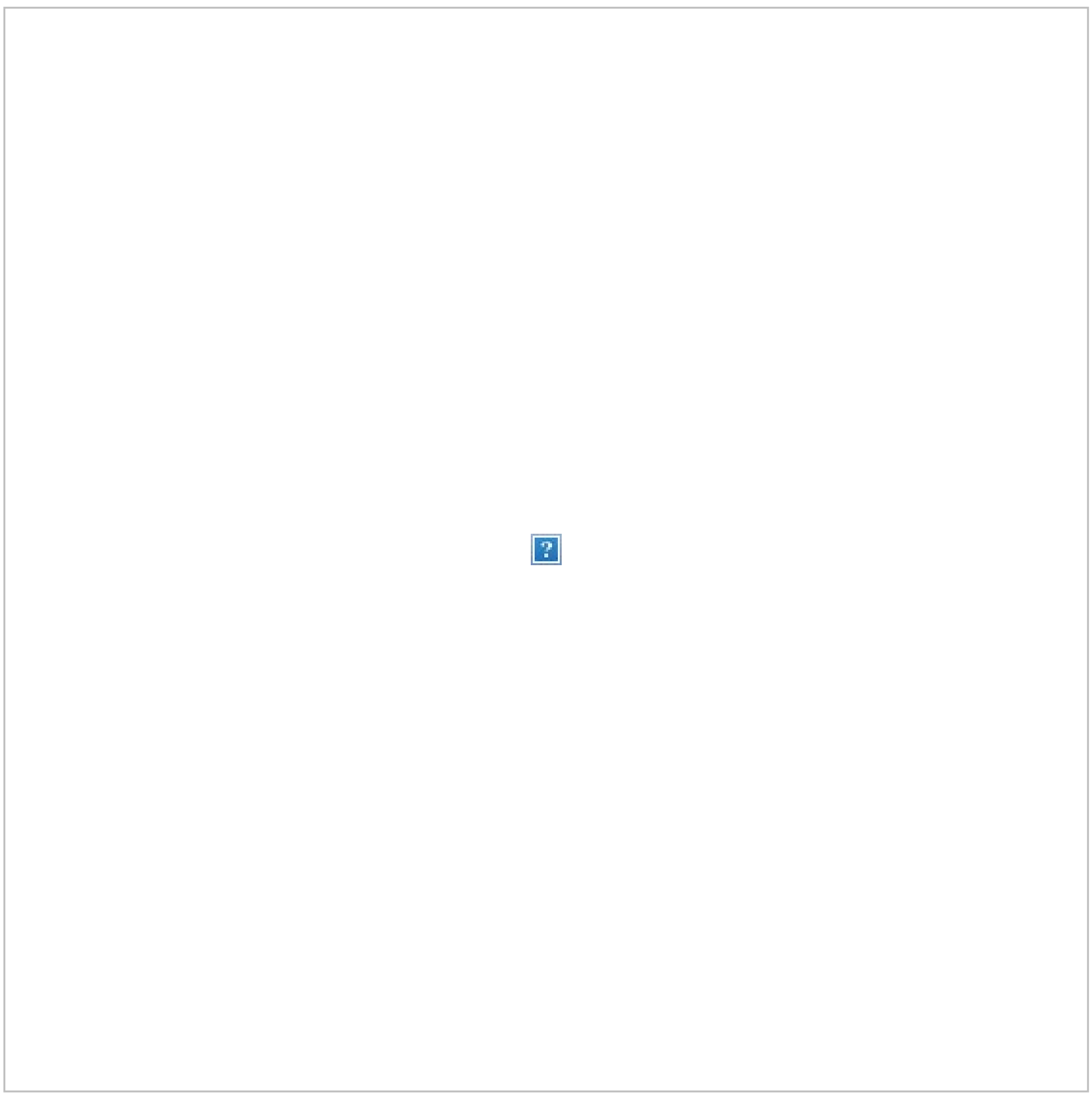
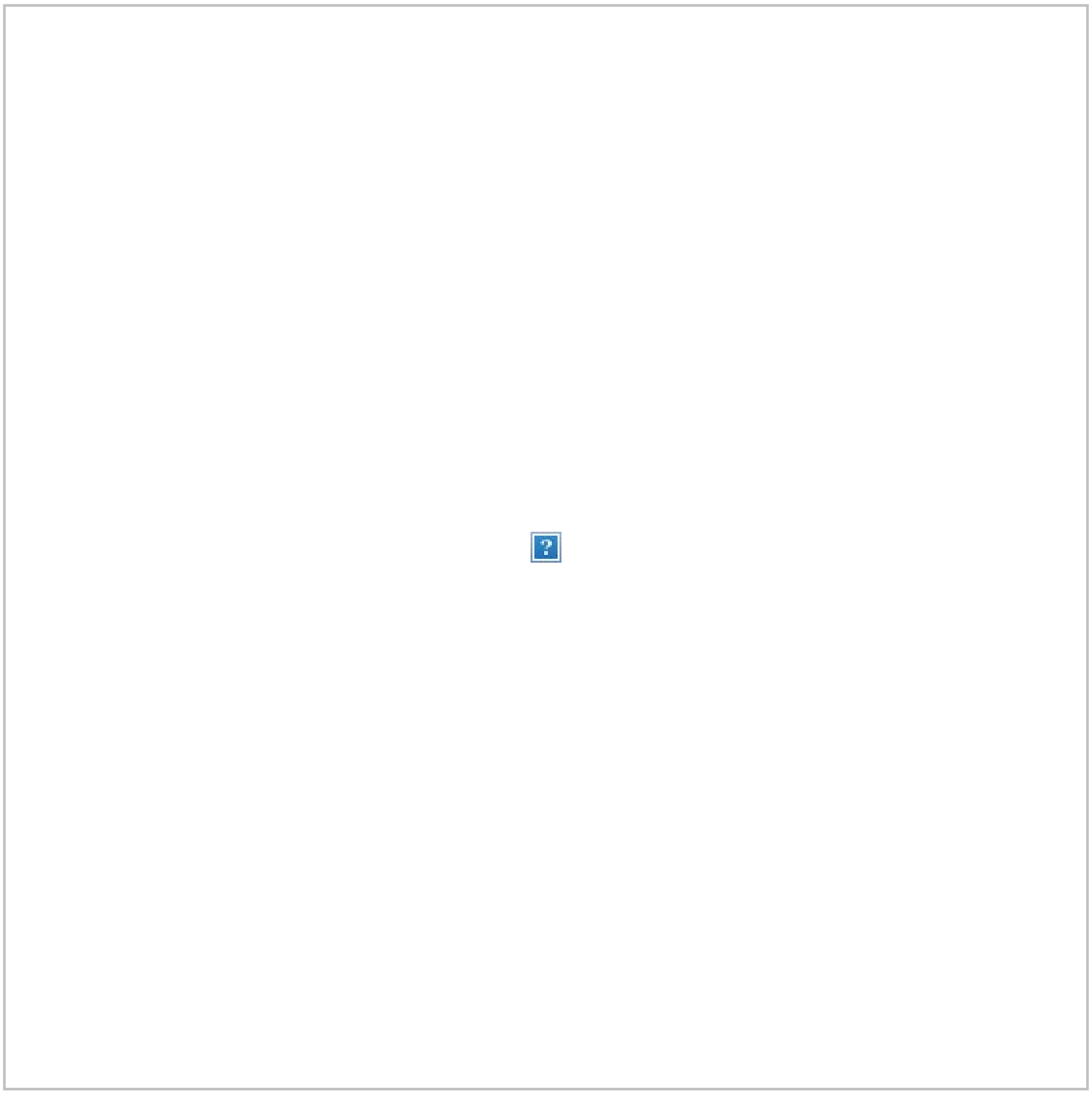
Dear GFC Supporters and Legislators,

Last week Governor Gavin Newsom released the "May Revision" to the 2019–20 budget he initially proposed in January. The May Revision kicks off negotiation with the legislature over the budget for the next fiscal year, which commences July 1.

Because California's tax revenues are so dependent upon unpredictable capital gains, when a governor issues the January budget proposal little is known about the revenues for a fiscal year that won't start for another six months. The May Revision updates those revenue predictions—but as the chart below illustrates, still no one really knows what will happen to state revenues over the twelve months starting July 1:



The May Revision predicts record tax revenues and a "surplus" (it's not really a surplus; see * below) of $21 billion for the 2019–20 fiscal year. To his great credit in our view, Governor Newsom proposes deploying most of the surplus to paying down debt, building reserves and one-time or short-term expenditures. He chooses that path because "a moderate recession could result in revenue declines of nearly $70 billion and a budget deficit of $40 billion over three years":



In so proposing, Governor Newsom is effectively protecting discretionary programs funded by the General Fund, such as UC, CSU, courts, parks and some social services. That's because when revenues decline in a recession, discretionary programs get crowded out by entitlements, debt service and other expenditures that don't decline because they are constitutionally, contractually

or statutorily protected. He's also protecting tax-, tuition- and fee-payers, who in the absence of reserves such as those Governor Newsom is asking the legislature to create get asked to pay more just to maintain existing levels of services. Governor Newsom is also saving money for K-12 at a time when school districts are dangerously low on their own reserves.

In our view, it's courageous for Newsom to behave in such a fiscally-prudent fashion when political incentives are usually to spend. At the same time, however, we are disappointed the governor did not propose to means-test expensive insurance subsidies provided retired state employees, including retirees already subsidized by Medicare or entitled to Affordable Care Act subsidies. Known as "Other Post-Employment Benefits", or "OPEB," those subsidies will claim $2.8 billion in General Fund cash this year at the expense of discretionary programs. Another ~$3+ billion of cost is being accrued and added to OPEB liabilities, which already exceed $90 billion and the service of which will come at the expense of future discretionary programs. OPEB is eminently reformable, as illustrated by the City of Glendale which elected to means-test OPEB and liberate funds for current city needs and employees.

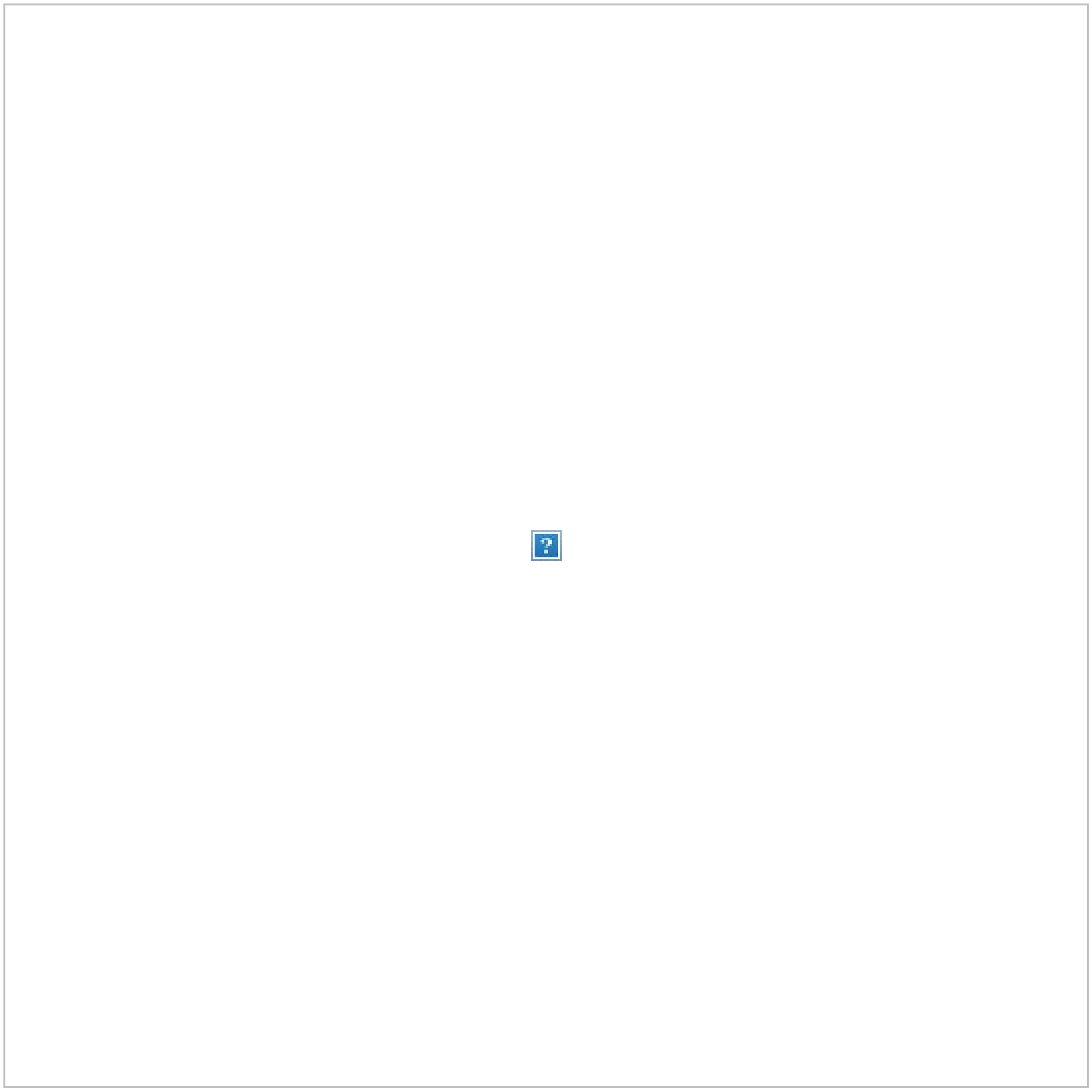
We are also disappointed the governor chose not to propose bold reforms to three underperforming state services. In our federalist system of government, states provide most domestic public services, including education, health and prisons. Politics is too often about the next new thing but the core responsibility of states is to deliver critical domestic services. In that regard California is falling well short. The General Fund's largest expenditures pertain to three services that have declined or not improved despite big increases in spending:

K-12: At $100 billion per year, the state's schoolchildren should be getting more from their schools. Spending is up 60 percent since 2010 to >$17,000 per student this year, yet teachers have gone on strike because so little of the new money is reaching them, school districts are cutting programs and laying off employees, and student performance is unchanged:

We speculate Governor Newsom knows what's needed to make K-12 work. After all, he ran successful businesses in which he—*unlike California school boards operating under laws written by the governor and legislature*—was able to fire underperforming employees, pay more to employees who perform better or take on tougher assignments, and wasn't required to grant tenure to employees or to lay off employees in reverse seniority. With his approval and that of just 62 legislators, those rules could be changed so school boards could be liberated to jump-start an ossified K-12 system that presently has more in common with a Soviet-style system run for the benefit of a *nomenklatura* than for customers—six million kids. They should also require districts to carry larger reserves and means-test OPEB.

Medi-Cal: The governor and legislature run Medi-Cal, which is a voucher-type system costing $100 billion per year that covers 13 million—1 in

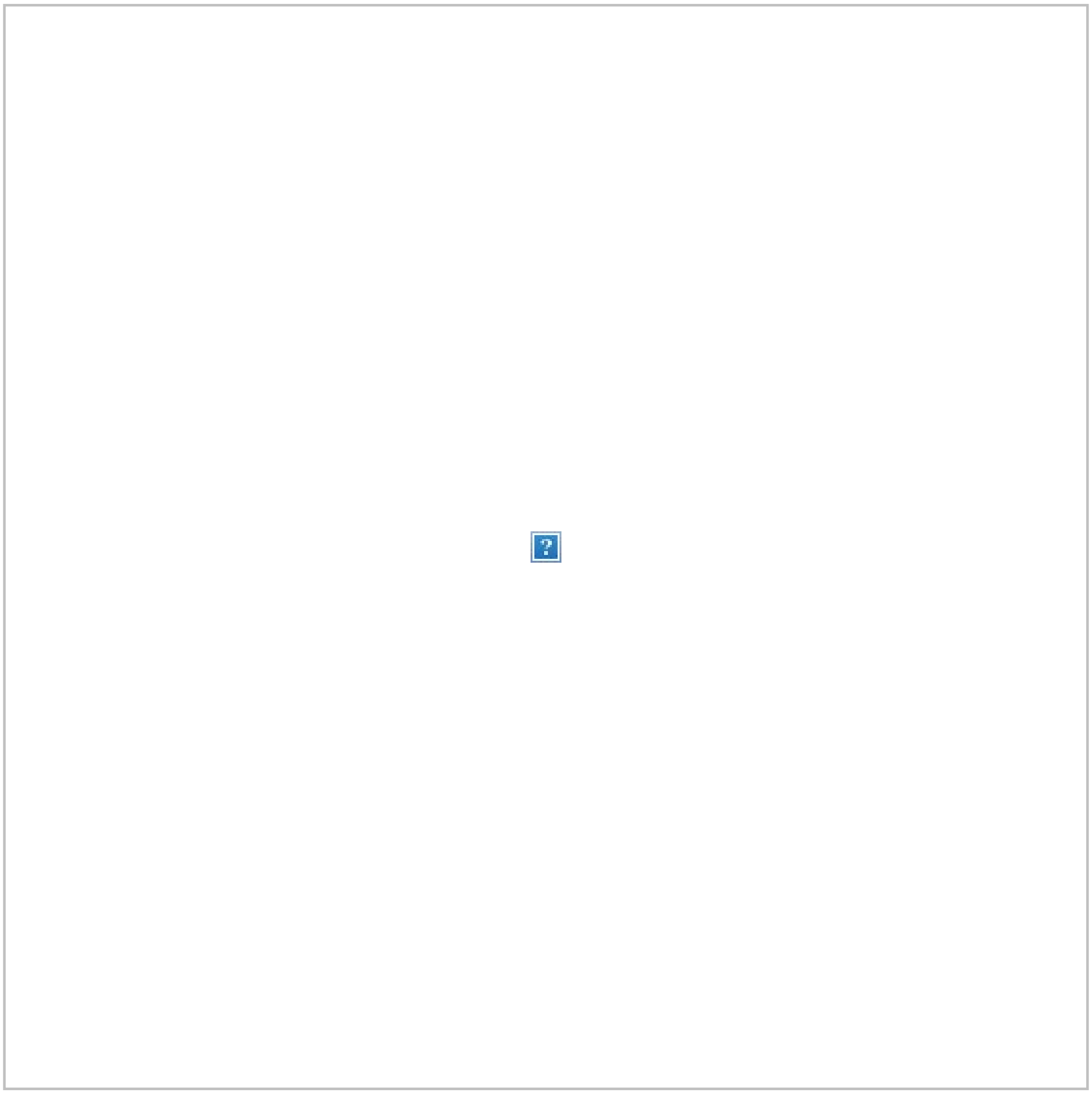
3—Californians. Despite a doubling in spending including federal funds since 2010, a recent National Bureau of Economic Research study about California reports no significant improvement in patient health and no reduction of emergency room usage—yet a significant improvement in hospital profits.



We have our own views about why big spending increases have produced bigger profits but not better health and the changes the state should make (eg, liberate nurse practitioners, physician assistants and nurse midwives to provide better access and more medical services, reward excellent and punish poor hospital performance, evaluate Maryland’s global hospital budgets policy, and use machine-learning and social services to intervene before costly medical treatment is required). Bills have been introduced to effect some of those types of changes and if they make it through the legislature we hope the governor will

sign them. But more generally we would like to see a greater focus on getting value—ie, *better health!*—for $100 billion per year.

Corrections and Rehabilitation (CDCR): Since 2010 the state's inmate population has dropped >20 percent to 127,000 inmates and staffing has declined 15 percent to 57,000 employees but salary spending has risen nearly 30 percent:



At $12.8 billion per year plus $~3 billion in OPEB and pension costs, General Fund spending on CDCR is more than General Fund spending on UC, CSU, Courts, Parks and Forestry/Fire Protection *combined*. While to his credit the governor makes several proposals to improve rehabilitation, there are no proposals to close prisons or to reduce staffing or compensation costs. We believe 127,000 inmates can be supervised for less than $15 billion per year.

We are under no illusion about the political difficulties associated with reforming K-12, Medi-Cal and CDCR. Governors alone can't do it—they need at least 62 votes from a legislature fearful of powerful organizations representing hospitals, doctors, teachers, prison guards and other special interests. While we've never met a legislator who supports (say) California's law requiring school districts to lay off teachers in reverse seniority, because of that fear we run across very few willing to carry a bill to change that rule. In our view, expressions of interest by the governor in such reforms could help motivate legislative actions.

Govern For California supports lawmakers who legislate in the general interest.

David Crane
President

*The state is projecting a fictitious $21 billion surplus in the next fiscal year by understating expenses through the use of "cash-basis" budgeting and high discount rates, as illustrated in a four-part series published in 2017 that may be found here, here, here and here. California is not unique among states in using cash-basis budgeting and high discount rates.

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